

Brad Molnar
3-30-07

STATE NATURAL RESOURCES
COMMITTEE NO. 18
DATE 3-30-07
HB 25

BRAD MOLNAR'S TESTIMONY ON HB 25

I have always stood as a supporter HB 25. I have even championed HB 25 over competing legislation. However my support has always been provisional and my concerns have never been addressed so I now rise to offer my insights and ask that you give them consideration HB 25 goes through the system.

I believe that my concerns are acknowledged and it is simply hoped that they are not adopted so that business as usual can be accomplished while putting new tires on a collapsed chassis.

Those of you that have been around for a while may remember that a well intentioned Senator in 1997 pushed a good sounding deal. Very few understood it yet followed on faith and strength of argument. The concept became internalized by the Senator, focus got lost, and the rest is history. This is our chance to learn from history. Hopefully, if HB 25 becomes law it will be thought out well enough that we will not need to have major rewrites the same as we have had every session since 2001. Hopefully the voice of the utility will not, once again, be the only voice heard. To that end I offer the following:

SUPPLY PROCUREMENT

Re-regulated or not, we shall be "in the market" in a very big way for many years to come. The problem is that if NWE is a bidder into the supply, therefore also a competitor to the other bidders, then the other bidders will not give the required proprietary information to NWE. They won't do it for energy supplies and they won't do it for generation construction. This lack of competition will certainly drive up prices. There needs to be third party oversight established. It can't wait till we have RFPs with no respondents. (Latest auction)

I have raised this issue with Rep. Olson since the first hearing. As a matter of fact I raised it last session on Rep. Olson's then re-reg. bill. There can only be one reason to continue to ignore the obvious. If third party oversight can not be accomplished then HB 25 should not go forward.

UPON PASSAGE

Upon passage I can generate more electricity by shuffling across the floor in wool socks than NWE can generate in a year. They will have nothing to generate with for a long time. And, by statute, they will have no obligation to acquire generation. It's all voluntary. NWE can continue in our current happenstance. Supposedly the reason for HB 25 is to institute a vertically integrated utility. But how can you have a vertically integrated utility without generation capacity? Throughout the BBI/NWE hearings no one said that there was any intention to build generation. Only two transmission projects were mentioned. The written testimony acknowledged the need to serve the default supply but doing so through the acquisition of generation assets was not mentioned other than as possible legislation. When specifically asked about procuring a regulating capacity Steve

Bolton CEO of BBI had no idea what it was. Certainly they had never discussed generation. At my Billings meeting I asked Mr. Jaarsveldt, BBI's general manager of regulation, and David Gates, NWE vice president of wholesale operations, "We need base load, sculpted load and peak load capacity. If HB 25 passes what will be your first two construction projects?" The answers were, "Don't know" and "Haven't thought about it." If all the PSC can do is comment of procurement plans (Current practice and re-stated in HB25) then how have we taken control of our destiny? We really need the legislative authority to order that certain procurement happen; be it long term contracts and/or generation capability. To do otherwise is to wait and see what suits NWE shareholders rather than NWE ratepayers which is our status quo. To do otherwise is to render this bill meaningless for currently NWE can build generation and put it into the supply portfolio. The same as they tried with First Montana Megawatts. To do otherwise is to grant capacity to NWE without obligation. Perhaps generating enough theoretical earning capacity to raise appraisal values to \$37 per share is the underlying intent

THE MORNING AFTER/THAT DANG REALITY

Let's assume that HB 25 passed in its current form. How much generation can we expect? Using the most recent numbers from the SME project near Great Falls the cost of four 250 megawatt plants would be \$3B. That would totally idle Colstrip 1-3 and export the hydro resources out of state. But PPL would still control transmission rights and the Q for new energy supplies on our existing lines is about 20 years so we would need to build new transmission line (NWE would like that but rate payers would not). This could easily be another several billion dollars and both would take decades.

Let's assume HB 25 in its present form passes and NWE opted to build a regulation generator. (Because of regional wind development and specifically Judith Gap this would be a matter of self defense.) It would probably be a gas generator. The largest cost would be the natural gas. Natural gas is federally deregulated. So what would the PSC regulate? The procurement contract. This would be simple because no one would hand their bid over to their competitor in the bidding process. And, as is currently the case with the Basin Creek facility, we would only regulate the maintenance contract. Is this what you had in mind for a re-regulated system? Would we even want a rate based gas plant on the backs of the ratepayers when certainly the technology for such plants would certainly make any plants built today obsolete in twenty years? Perhaps, just perhaps, the best avenue for this particular development is long term lease. Perhaps it should not even be a part of this debate.

ALL ON THE TABLE/YOU OWE IT

The stated reason HB 25 was brought forward is that NWE wants the ability to acquire rate based generation. However, they do not want their generation to be rate based. (?) That is odd. NWE controls 222 MW of thermal generation in Colstrip 4. Short term 90 MW are pledged to the Default supply. The balance is leased out. Through out their

written testimony NWE talked of buying out the contracts. Now is a good time. The contracts should be supplied to the people of Montana at just and reasonable rates. This is very much against my docile nature so let me explain why I take this stand. (Hand out)

The reason NWE appeared large enough to buy Montana Powers transmission assets is that, apparently, they were willing to commit fraud and continue the fraud until the house of cards came down. Because of a poor credit rating NWE never had a capacity to procure electricity in long enough contracts, or natural gas with favorable enough terms, to assure their customers the lowest long term costs as provided by law. Nor were they capable of acquiring short, medium, and long term electricity contracts (as required by PSC rule) so we have always been in the market as panicked buyers. Our families and employers have suffered. If the worst that happens to NWE, and their share holders, is that they are punished by receiving "just and reasonable rates" they should change their name to "The Smiley Electricity Company."

PREAPPROVAL/A NECESSARY EVIL

I stand in favor to the portion of the bill that maintains pre-approval as a methodology to promote development. I do this despite the unqualified failure of the three most recent pre-approvals. Docket D99.4.82 deregulated Montana Power and PPL despite prohibitions of same. Docket D2001.1.5 The sale of Montana Power Co. transmission assets to NowthWestern Corp. based on a transition plan that was never accepted and fraudulent financial information given. And Docket D2005.2.14 which allowed Judith Gap wind farm into the default supply despite the fact that ancillary supplies were known to be in short supply and cost warnings from the Montana Consumer Council. As you know we face imminent consequences because of this shortsightedness.

The problem is systemic and needs to be addressed but there is no workable substitute under today's financial realities.

CONCLUSION

There is no rush. We have seven year's worth of electricity contracts and NWE is now financially capable of getting longer term contracts. Just like co-ops. The original "De reg" bill SB 390, actually handled two major problems and established a five year study on the desirability of deregulation. The study was cut to two years and deregulation (EWG status) happened on May 25, 1999. Had the PSC waited just six months more the California melt down would have started and shown the downside of too much market exposure. In contrast HB 25 is the product of several meetings of the FRET interim committee and massive amounts of amendments. Do you really trust six people on a Freestanding Conference Committee to make the final determination for our energy future? The best course of action is to find out who will own NWE and how solid they turn out to be. And to study not what words will be used to create another vertically integrated utility but rather to consider what happens after the bill is signed and the cameras go away. A good start would be to subsume into HB 25 the study bill HB 626. The intent of HB 626 is to make our system as functional for the people of Montana as

possible regardless of structure label. If you do include it be sure to keep application away from the FRET sub committee. Partisan solutions and utility controlled legislators have proven to not be the answer.

If this is going into a sub committee I will gladly work with them and, should you so ask, will work on the necessary amendments for my recommendations.

POLITICAL POTPOURRI IV

Questions? Concerns? Comments about Gov't or energy policies?

Address them to bmolnar@mt.gov

BANKRUPTCY MEANS NEVER HAVING TO SAY YOU'RE SORRY

Ask any person why NorthWestern Energy (NWE) went bankrupt and they will recite, "Bad outside investments." Yeah right. How about fraud?

After months of sworn testimony, in Feb. of 2002, NWE acquired the transmission assets of the old Montana Power Company. They swore they were worth billions of dollars and obtaining the transmission assets would only bring stability and great service to the people of Montana. September 2003 NWE declared bankruptcy; but not because several acquisitions suddenly went bad.

According to a Securities and Exchange Commission (SEC) report issued March 7, 2007 NWE, mainly concerning two subsidiaries, Blue Dot and Expanets, materially misrepresented their financial position for the first three quarters of 2002 by 176%, 618%, and 109% respectively. When these two companies were written off they were written off as a \$900M loss. During the acquisition process they were shown as substantially adding to NWE's financial strength.

False strength was shown by not publicly recognizing a mounting accounts receivable problem with the subsidiaries. Cash reserves set aside to handle the accounts receivable shortage reappeared as fresh earnings. The net result was NWE overstated its income for the first three quarters of 2002 by 16%, 19%, and 39% respectively via understating Expanets operating loss for the first quarter of 2002 by 66% and overstating its operating income by approximately 86% and 270% for the second and third quarters of 2002.

Employing "improper accounting for billing adjustments" NorthWestern overstated its income by 98%, 46%, and 31% respectively for the first three quarters of 2002. And NWE understated Expanets operating loss by approximately 87% for the first quarter of 2002 and overstated Expanets operating income by approximately 1094% (Not a typo. It really is 1094%) and 164% respectively for the second and third quarters of 2002.

In the first quarter of 2002, \$2.6M of Expanets income was derived by transferring funds dedicated to covering bad debt to the profit side of the ledger. Second quarter of 2002 \$8.8M of Expanets income was derived from "reserve reductions". Third quarter of 2002 \$27M of Expanets income was derived from "reserve reductions". For the third quarter alone this allowed NWE to be able to post a \$14.6 million dollar profit for continuing operations rather than a significant loss.

Expanets bought out a competitor and the competitor agreed to make payments so as to not have Expanets compete in certain markets. These "non-compete" payments were never reported as "unusual transactions". Rather, they showed up as normal income from continuing operations. In first three quarters of 2002 these undisclosed non-compete

payments boosted NWE's shown income from continuing operations by 25%, 31%, and 68% respectively.

At the same time these subsidiaries were showing healthy profits NWE was providing intercompany advances. First quarter of 2002 advances totaled \$63.3M. By the end of the third quarter of 2002 the intercompany advances totaled \$113.4M. These advances could no longer be hidden so were reported in September of 2002.

When the acquired subsidiary, Blue Dot, acquired other companies it often tendered its own stock as partial payment. A third party appraiser in 2nd quarter of 2002 appraised Blue Dot common stock as "worthless". NorthWestern did not immediately disclose this loss of value but rather charged off the losses to minority interests (those acquisitions that had taken the now worthless stock). This allowed NWE to overstate its income from continuing operations by 63%.

These are the findings of the Securities and Exchange Commission which basically has told NWE to please stop being so darn fraudulent. Without admitting or denying the findings Northwestern Corporation has said "OK." I don't think it is "OK."

Not only were many people's lives, business, and retirements ruined but NWE was never in a financial position to be the default supplier capable of providing electricity at "just and reasonable rates" for Montanan's as required by law. Because of their precarious financial position they had to pay higher amounts (just like anybody with poor credit) and pass the higher costs on to you.

Under current interpretation of Montana law, if a utility via the Montana Public Service Commission, engages in fraudulent activities and no one discovers the fraud within thirty days the fraud is irreversible by the courts. Conversely, you can take action up to two years after the discovery of the fraud (IE. You purchase a home but when you go to sell it you discover that the seller did not disclose it was built on a toxic waste dump). I and Rep. George Everett (R) Kalispell tried to change the law (HB 659) to hold utilities and the PSC to the same standard as you are; two years after discovery. Though originally aimed at the fraud and collusion I accuse the PSC and PPL of in the deregulation of Montana Powers generating facilities it certainly would have applied to this issue or to any potentially dastardly deeds in the BBI/NWE question. The bill had only two opponents; NorthWestern Energy and (after a 3-1-1 vote to oppose the anti-fraud bill) Greg Jergenson, Chairman of the Montana Public Service Commission. The only legislative committee member to speak against HB 659 was Rep. Alan Olson (R) Roundup who offered that HB 659 was "a solution looking for a problem that might cause problems in the future." The anti fraud bill AKA HB 659 died in committee.

Brad Molnar
Montana Public Service Commissioner

Brad Moran
444-6165
3-30-07

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55416 / March 7, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2573 / March 7, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12585

In the Matter of

**NORTHWESTERN
CORPORATION,**

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS, MAKING
FINDINGS AND IMPOSING A CEASE-
AND-DESIST ORDER PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against NorthWestern Corporation ("NorthWestern" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

During the first three quarters of 2002, NorthWestern filed quarterly and current reports with the Commission that materially misstated NorthWestern's financial position and misrepresented or did not disclose required information about its non-utility businesses, Expanets, Inc. ("Expanets") and Blue Dot Services, Inc. ("Blue Dot"). In its filings, after the effect of taxes, NorthWestern overstated its income from continuing operations for the first three quarters of 2002 by approximately 176%, 618%, and 109%, respectively, due to the company's improper accounting for accounts receivable, adjustments to customers' bills, and allocation of losses to minority interests. NorthWestern also misrepresented or did not disclose, among other things, the effects of significant problems with Expanets' new information technology system, the material impact of Expanets' reserve reductions and its receipt of non-compete payments on Expanets' income, large intercompany advances NorthWestern made to support Expanets and Blue Dot, and the timing of anticipated payments from the sale of certain utility assets. Through its financial misstatements, misrepresentations, and omissions, NorthWestern obscured the continuing poor performance of its subsidiaries at a time when it was publicly relying on these subsidiaries' operations to strengthen its financial condition.

Respondent

1. NorthWestern, a Delaware corporation with its principal executive offices in Sioux Falls, South Dakota, operates a regulated utility business in South Dakota, Nebraska, and Montana. During the period of conduct discussed herein, NorthWestern consolidated the financial results of two non-utility entities, Expanets and Blue Dot. NorthWestern's common stock was registered with the Commission under Section 12(b) of the Exchange Act and traded on the New York Stock Exchange until it was delisted shortly before NorthWestern declared bankruptcy in September 2003. In November 2004, NorthWestern emerged from bankruptcy. Its common stock is now registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ Global Select Market.

Other Relevant Entities

2. Expanets, formerly headquartered in Englewood, Colorado, was formed by NorthWestern in 1997 and provided networked telecommunications equipment and services to medium-sized businesses nationwide. NorthWestern wrote off substantially all of its investment in Expanets during the fourth quarter of 2002 as disclosed in the company's 2002 Form 10-K and announced its intention to sell Expanets in April 2003. In the second quarter of 2003, Expanets'

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

operations were discontinued, and in May 2004, Expanets (n/k/a Netexit) filed for Chapter 11 bankruptcy protection. Proceeds from the sale of Expanets' assets were distributed in bankruptcy.

3. Blue Dot, formerly headquartered in Sunrise, Florida, and Sioux Falls, South Dakota, was formed by NorthWestern in 1997 and provided heating, ventilation and air conditioning ("HVAC") services nationwide. NorthWestern wrote off substantially all of its investment in Blue Dot during the fourth quarter of 2002 as disclosed in the company's 2002 Form 10-K and announced its intention to sell Blue Dot in April 2003. In the second quarter of 2003, Blue Dot's operations were discontinued, and NorthWestern thereafter sold or closed each of Blue Dot's HVAC businesses.

Background

4. For more than seventy years, NorthWestern operated a public utility business, providing electricity and natural gas to customers in South Dakota and Nebraska. In the late 1990s, NorthWestern formed Expanets and Blue Dot (the "non-utility businesses") to diversify into the telecommunications and HVAC sectors. NorthWestern's business plan was to acquire small telecommunications and HVAC companies and make them more profitable through central management, national branding and other economies of scale.

5. From 1998 through the end of 2001, Expanets acquired twenty-six small telecommunications companies and a sales division of a large competitor. From 1997 through the end of 2001, Blue Dot acquired over ninety different HVAC and plumbing companies. By the end of 2001, NorthWestern had invested hundreds of millions of dollars in Expanets and Blue Dot to make these acquisitions and build those subsidiaries' central management. However, Expanets and Blue Dot incurred losses during most years and posted only small profits in other years. Because of their performance, Expanets and Blue Dot required investments of substantial amounts of cash by NorthWestern.

6. In February 2002, NorthWestern effectively quadrupled its utility customer base by acquiring Montana Power Company ("Montana Power") for approximately \$1.1 billion. NorthWestern originally financed its acquisition of Montana Power by utilizing, among other things, a \$720 million acquisition loan. In March 2002, as part of a debt offering to retire the acquisition loan, NorthWestern issued \$720 million in the form of senior notes.

7. The magnitude of NorthWestern's increased debt as a result of the Montana Power acquisition threatened the company's credit ratings. As a result, NorthWestern announced its intention to conduct an equity offering during 2002 to raise approximately \$200 million to pay down its debt and improve its debt/equity ratios.

8. NorthWestern recognized that improvement in the performance of both Expanets and Blue Dot was critical to its planned equity offering. NorthWestern made public statements that both Expanets and Blue Dot would achieve 2002 targeted earnings and begin providing cash to the NorthWestern consolidated entity in 2002.

9. NorthWestern conducted its equity offering during the third quarter of 2002, and raised approximately \$87 million. Also during the third quarter of 2002, NorthWestern completed its registration and exchange of new notes for \$720 million of debt it incurred to purchase Montana Power.

10. In December 2002, NorthWestern disclosed that significant operational problems at Expanets and Blue Dot would materially impact the company's consolidated year-end financial results. In April 2003, NorthWestern filed its 2002 Form 10-K and simultaneously restated each of its Forms 10-Q for the first three quarters of 2002. NorthWestern's restated Forms 10-Q corrected material misstatements of previously reported financial results relating to Expanets and Blue Dot, and disclosed various operational difficulties these subsidiaries experienced throughout 2002. NorthWestern's 2002 Form 10-K further disclosed that the company did not anticipate recovering its past investments of hundreds of millions of dollars in Expanets and Blue Dot, and that neither entity would generate cash flows in sufficient amounts to provide meaningful contributions to service NorthWestern's debt load. NorthWestern's liquidity situation continued to deteriorate until the company filed for bankruptcy in September 2003. NorthWestern stock, which had traded for more than \$20 per share in early 2002, was trading for less than a dollar by the time NorthWestern filed bankruptcy.

Problems Relating to Expanets' Computer System

Functionality of the EXPERT System

11. During 2000 and 2001, Expanets developed an information technology system, called the "EXPERT" system, to serve as a platform for virtually all of its operations, including sales, inventory, project management, billing, collections and financial statement preparation. Because of its planned scope and impact across operations, the functionality of the EXPERT system was critical to Expanets.

12. However, following its implementation in November 2001, the EXPERT system was unable to perform many of the basic tasks for which it had been designed. For example, for approximately a month after it was implemented, EXPERT could not generate any customer bills. From January through May 2002, many customer bills EXPERT generated were incomplete and inaccurate. Until approximately September 2002, the EXPERT system also could not properly apply cash collected to customer accounts or track the aging of accounts receivable balances. These problems materially affected Expanets' results from operations throughout 2002.

13. NorthWestern's Forms 10-Q for the first and second quarters of 2002 and associated press releases attached to Forms 8-K mischaracterized EXPERT's billing activities as "fully operational" or "operational" and failed to adequately disclose the magnitude of the system's problems and the material impact of those problems on Expanets' operations. In its Form 10-Q for the third quarter of 2002, NorthWestern disclosed that EXPERT had encountered some problems, particularly as to billings and collections, but did not disclose the extent to which these system problems had impacted Expanets' operations. NorthWestern did not fully and adequately disclose the severity of the problems with the EXPERT system and the impact of those problems on

Expanets' operations until April 2003 when it filed its 2002 Form 10-K and restated its Forms 10-Q for the first three quarters of 2002.

Aged Accounts Receivable

14. In anticipation that some customer accounts might prove uncollectible, Expanets maintained a "bad debt" reserve, which had the effect of reducing Expanets' operating income. Prior to its implementation of EXPERT, Expanets calculated its bad debt reserve based on the age of uncollected receivables outstanding in a given period. However, during the first and second quarters of 2002, the EXPERT system could not properly apply cash collected from customers to their accounts or accurately track the aging of Expanets' accounts receivable. As a result, rather than considering the age of all of its receivables, Expanets estimated its bad debt reserve based on the percentage of revenue that had typically resulted in uncollectible accounts receivable.

15. Expanets' bad debt reserve in 2002 was inadequate. As an initial matter, Expanets did not make appropriate adjustments for known aged receivables that pre-dated implementation of the EXPERT system.

16. Expanets also failed to increase its bad debt reserve despite the markedly increased difficulties with collections that resulted from the EXPERT system's problems. For example, since EXPERT could not apply cash collected to the proper accounts, Expanets could not determine from which customers to seek payment, causing uncollected receivables to age further.

17. Beginning in the third quarter of 2002, for the first time, the EXPERT system was able to generate accurate accounts receivable aging reports. These reports demonstrated that Expanets' uncollectible accounts receivable exceeded its existing bad debt reserve by tens of millions of dollars. Despite such data, Expanets did not increase its bad debt reserve or directly write off uncollectible accounts receivable.

18. In its first and second quarter Forms 10-Q, NorthWestern did not disclose information indicating that a loss as a result of its uncollectible accounts receivable was probable or reasonably possible. In its third quarter Form 10-Q, NorthWestern disclosed that the EXPERT system's problems might lead to an increase in Expanets' bad debt reserve. However, this disclosure was inadequate since NorthWestern knew at that time that Expanets' bad debt reserve was materially insufficient.

19. In December 2002, NorthWestern announced that it anticipated that Expanets would take substantial charges in the fourth quarter relating to Expanets' uncollectible accounts receivable. In April 2003, NorthWestern restated its Forms 10-Q for the first three quarters of 2002 and increased Expanets' bad debt reserve for each of these periods by approximately \$5.2 million, \$5.1 million, and \$6.3 million, respectively.

20. As a result of its improper accounting for uncollectible accounts receivable, NorthWestern overstated its income from continuing operations by approximately 16%, 19%, and 39% for the first three quarters of 2002, respectively, as reported in its Forms 10-Q and press

releases attached to Forms 8-K. Moreover, in its segment reporting for Expanets, NorthWestern understated Expanets' operating loss by approximately 66% for the first quarter of 2002, and overstated Expanets' operating income by approximately 86% and 270%, respectively, for the second and third quarters of 2002.

Adjustments to Customer Bills

21. As a result of the inaccurate customer bills generated by the EXPERT system, Expanets issued partial credits to affected customers. Expanets recorded these credits as "billing adjustments," which reduced both its revenue and income in the current period. Since Expanets credited customer accounts in periods after it initially recognized revenue from a transaction, Expanets maintained a "billing adjustment reserve" for anticipated credits to customer accounts. Expanets calculated its billing adjustment reserve based on the revenue it billed, its actual billing adjustments during the reporting period, and its evaluation of the aggregate accuracy of its customer bills.

22. Because EXPERT generated a significant number of inaccurate and incomplete customer bills in the first quarter of 2002, Expanets' billing adjustments in the first quarter of 2002 surpassed projected levels of approximately \$2 million per month and reached more than \$3 million for March 2002. During the first quarter of 2002, Expanets also internally forecasted that EXPERT's billing accuracy problems would continue for several months. Still, Expanets increased its billing adjustment reserve by a net of only approximately \$1.5 million in the first quarter of 2002.

23. As EXPERT billings problems persisted during the second quarter of 2002, Expanets' billing adjustments significantly exceeded originally-projected levels and reached approximately \$6 million for the month of June 2002. Expanets estimated that its billing adjustments would be \$13 million higher than it had originally forecasted for the remainder of the year. However, Expanets did not increase its billing adjustment reserve to comport with these internal forecasts. Instead, Expanets reduced its billing adjustment reserve by \$2.3 million during the second quarter, thereby increasing its operating income by the same amount.

24. For the third quarter of 2002, Expanets' billing adjustments totaled more than \$22 million, which again significantly exceeded its original and revised projections. Expanets further estimated that, due to a planned correction of a certain category of customer bills, its billing adjustments for the fourth quarter would exceed its revised estimates by an additional \$3.4 million. However, Expanets again did not increase its billing adjustment reserve. Instead, it reduced this reserve by \$4 million during the third quarter, which increased Expanets' operating income by the same amount.

25. In December 2002, NorthWestern announced that it anticipated that Expanets would take substantial charges in the fourth quarter relating to Expanets' billing adjustments. In its April 2003 restatements for the first three quarters of 2002, NorthWestern acknowledged that it had understated its billing adjustment reserve in each of these quarters, and as a result, the company

reduced reported revenues and income by approximately \$18.3 million, \$10.1 million, and \$5.4 million, respectively.

26. As a result of its improper accounting for billing adjustments, NorthWestern overstated its income from continuing operations by approximately 98%, 46%, and 31% for the first three quarters of 2002, respectively, as reported in its Forms 10-Q and press releases attached to Forms 8-K. In its segment reporting for Expanets, NorthWestern understated Expanets' operating loss by approximately 87% for the first quarter of 2002, and overstated Expanets' operating income by approximately 1094% and 164%, respectively, for the second and third quarters of 2002. NorthWestern also did not disclose in any of its filings for the first three quarters of 2002 that losses resulting from billing adjustments were probable or reasonably possible.

The Quality of Expanets' Income

Reserve Reductions

27. During the first three quarters of 2002, Expanets reduced amounts it had recorded in at least fourteen of the reserve accounts it maintained on its balance sheet, including the billing adjustments reserve account discussed above. These reductions materially increased Expanets' and NorthWestern's income.

28. In the first quarter of 2002, \$2.6 million of Expanets' income was derived from reserve reductions. This amount reduced by approximately 50% Expanets' reported segment operating loss of approximately \$2.7 million and represented approximately 7% of NorthWestern's reported income from continuing operations for that quarter.

29. In the second quarter of 2002, \$8.8 million of Expanets' income was derived from reserve reductions. This amount represented approximately 80% of Expanets' reported segment operating income of \$11 million and approximately 27% of NorthWestern's income from continuing operations for that quarter.

30. In the third quarter of 2002, \$27 million of Expanets' income was derived from reserve reductions. With this income, Expanets was able to report \$8.7 million of operating income rather than a substantial operating loss. In addition, with this income, NorthWestern was able to report \$14.6 million of income from continuing operations for that quarter rather than an operating loss.

31. NorthWestern's Forms 10-Q for the first three quarters of 2002 did not disclose the material impact that these reserve reductions had on the reported results of operations of Expanets and NorthWestern during these periods. NorthWestern did not disclose the material impact of these reserve reductions until April 2003 when it restated its Forms 10-Q for the first three quarters of 2002.

Unusual Transactions

32. In conjunction with Expanets' acquisition of certain assets of a competitor, Expanets agreed that, in exchange for payments from the competitor, Expanets would not solicit specific business of the competitor's customers. Expanets' competitor was obligated to make these "non-compete" type of payments to Expanets until March 2005. These payments were not characteristic of Expanets' regular operations and therefore represented unusual transactions.

33. In the first quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had an operating loss of approximately \$2.7 million. Approximately \$9.3 million of Expanets' income came from the non-compete payments. The \$9.3 million also represented approximately 25% of NorthWestern's consolidated income from continuing operations for the quarter.

34. In the second quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had operating income of approximately \$11 million. Approximately \$10 million of Expanets' income came from the non-compete payments. The \$10 million also represented approximately 31% of NorthWestern's consolidated income from continuing operations for the quarter.

35. In the third quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had operating income of approximately \$8.7 million. Approximately \$15.3 million of Expanets' income came from the non-compete payments. The \$15.3 million also represented approximately 68% of NorthWestern's consolidated income from continuing operations for the quarter.

36. NorthWestern's Forms 10-Q for the first three quarters of 2002 did not disclose Expanets' receipt of these unusual non-compete payments and their material effects on Expanets' and NorthWestern's income. NorthWestern did not disclose the existence of these non-compete payments or their effect until it filed its 2002 Form 10-K and restated its 2002 Forms 10-Q in April 2003.

NorthWestern's Intercompany Advances to Expanets and Blue Dot

37. EXPERT's inability to generate any customer bills in late 2001 and early 2002 and other billing problems that followed caused Expanets' cash flow from operations during the first quarter of 2002 to be a deficit of approximately \$68.7 million. As a result, NorthWestern provided Expanets with significant intercompany advances during the first quarter of 2002 to enable Expanets to pay operating and other expenses, including a scheduled amount on a third-party credit facility. By the end of the first quarter of 2002, NorthWestern's intercompany advances to Expanets totaled \$63.3 million.

38. During the second quarter of 2002, EXPERT's continuing billing and collections problems caused Expanets' cash collections to lag significantly behind expected levels. NorthWestern therefore provided Expanets with additional intercompany advances of

approximately \$50 million to help Expanets pay operating expenses and another scheduled amount on a third-party credit facility. By the end of the second quarter, NorthWestern's intercompany advances to Expanets totaled \$113.4 million.

39. Similarly, during the first quarter of 2002, NorthWestern provided Blue Dot with approximately \$21 million in intercompany advances so that Blue Dot could pay off a large credit facility and operating expenses when due. NorthWestern's outstanding intercompany advances to Blue Dot totaled approximately \$37.1 million at the end of the first quarter of 2002.

40. In the second quarter of 2002, Blue Dot paid back some of the cash advanced by NorthWestern with proceeds from a one-time sale and leaseback transaction. Nevertheless, NorthWestern's outstanding intercompany advances to Blue Dot still totaled approximately \$22.8 million at the end of that quarter.

41. NorthWestern's intercompany advances to Expanets and Blue Dot demonstrated that these businesses were continuing to require further investments from the parent company, rather than providing cash to the consolidated entity. NorthWestern's need to advance funds to Expanets and Blue Dot was information that was necessary to understand NorthWestern's financial condition and was reasonably likely to impact NorthWestern's liquidity.

42. NorthWestern's Form 10-Q for the first quarter of 2002 did not disclose NorthWestern's intercompany advances to Expanets or Blue Dot, or the significance of those advances. NorthWestern disclosed in its Form 10-Q for the second quarter of 2002 that it made intercompany advances to Expanets. However, NorthWestern still did not disclose its intercompany advances to Blue Dot or any information about the significance of the intercompany advances to either subsidiary. NorthWestern did not disclose the existence and amount of its intercompany advances until September 2002.

Allocation of Losses to Blue Dot Minority Interests

43. When Blue Dot acquired other businesses, it paid the former owners in part with Blue Dot common stock. As a result of these transactions, the former owners held minority interests in Blue Dot. NorthWestern allocated a portion of Blue Dot's losses to these minority interests, which had the effect of increasing NorthWestern's consolidated income from continuing operations. This accounting treatment was proper only to the extent that the losses applicable to the Blue Dot minority interest did not exceed the minority interest in the equity capital of Blue Dot.

44. Before it filed its financial statements for the second quarter of 2002, NorthWestern received a third-party appraisal of Blue Dot for the purpose of assessing Blue Dot's enterprise value. Based on the total value of the Blue Dot entity as reflected in the appraisal, Blue Dot's common stock was worthless.

45. Despite this information, in its financial statements for the second quarter of 2002, NorthWestern allocated \$8.1 million of Blue Dot's losses to minority interests based on stock issued for acquisitions Blue Dot made that quarter. In addition, NorthWestern failed to disclose in

its second quarter Form 10-Q the material effects of the decrease in value of Blue Dot common stock, or any uncertainties about NorthWestern's ability to allocate losses to Blue Dot minority interests.

46. Because of its improper allocation of losses to minority interests, NorthWestern reported income from continuing operations of approximately \$20.9 million rather than \$12.8 million, an overstatement of approximately 63%, in its Form 10-Q for the second quarter of 2002 and a press release attached to a Form 8-K. NorthWestern reversed its allocation of losses to Blue Dot's minority interests when it restated its second quarter 2002 Form 10-Q in April 2003.

The Colstrip Utility Asset Sale

47. In February 2002, when NorthWestern purchased Montana Power, NorthWestern became the successor-in-interest to a contract for the sale of certain assets known as the "Colstrip" transmission assets ("Colstrip assets"). The contract called for a payment of approximately \$97 million to NorthWestern upon the satisfaction of certain conditions. During the second quarter of 2002, NorthWestern announced that it expected to collect the proceeds from the sale of the Colstrip assets by June or July 2002.

48. Throughout 2002, the sale of the Colstrip assets was significant to NorthWestern because it would have generated significant cash for the company and enhanced its liquidity position. Accordingly, analysts and rating agencies tracked the status of the sale.

49. Between May and July 2002, the other party to the Colstrip assets sale contract repeatedly informed NorthWestern that it would not close the sale until the parties were able to resolve other claims. On August 5, 2002, NorthWestern filed but did not serve a complaint against this party in a Montana State court.

50. NorthWestern's Form 10-Q for the second quarter of 2002 did not disclose the Colstrip asset sale dispute and its potential impact on NorthWestern's financial condition, including its impact on NorthWestern's liquidity. On September 4, 2002, NorthWestern served its complaint on the other party to the Colstrip sale and subsequently disclosed the existence of its lawsuit in its third quarter Form 10-Q. In May 2005, NorthWestern settled the lawsuit by agreeing to retain the Colstrip assets in exchange for, among other things, a \$9 million payment from the other party.

Violations

51. Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 require issuers to make and keep accurate books, records, and accounts, to file quarterly and current reports with the Commission, and to keep reported information current and not misleading. As a result of the conduct described above, NorthWestern violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

52. Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles. As a result of the conduct described above, NorthWestern violated Section 13(b)(2)(B) of the Exchange Act.

IV.

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent NorthWestern's Offer.

Accordingly, it is hereby ORDERED that Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary